Overexposed and Underreported: Climate Risks and the Financial Sector

A Roundtable to discuss and contribute to the FSB’s Task Force on Climate-related Financial Disclosure

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Washington, DC

Lead Discussants
Chair: Harris Gleckman, Sr. Fellow, Center for Governance and Sustainability, UMass-Boston
Jim Colburn, Ceres
Adam Kanzer, Domini Social Investments
Elizabeth Lewis, World Resource Institute (WRI)
Nicolai Lundy, Sustainability Accounting Standards Board (SASB)
Simon Zadek, Co-Director of UNEP Inquiry into the Design of a Sustainable Financial System

Opening Comments
Harris Gleckman, Senior Fellow at the Center for Governance and Sustainability, University of Massachusetts-Boston, opened the discussion by highlighting the important role that the investor and environmental communities must play in shaping the outcomes of climate-related disclosure for the financial sector. He explained that the FSB launched the Task Force on Climate-related Financial Disclosure (TCFD) as an exercise to focus on risks to financial stability. Harris emphasized that the FSB is receptive for ‘public’ input – and that we should take the opportunity to influence the task force.

Jim Colburn, Senior Manager of the Investor Program at Ceres, provided input from an investor’s perspective. He works with a coalition of investors devoted to establishing climate-related risk mitigation strategies. Jim stated that investors are now assuming a more active position and want not
only to report on corporate activities and emission levels, but also to engage with other companies and climate-related initiatives that are proposed by the FSB Task Force on Climate Related Financial Disclosure (TCFD).

Jim expressed his dismay with the Securities Exchange Commission for being disengaged with investors’ concerns regarding climate-related risks. Many investors attribute weaknesses in the current climate-related disclosure requirements to apathy among regulators. The SEC issued guidance on climate-related issues in 2007, but it failed to enforce this guidance – and this framework is of poor quality. Jim suggested that it would be useful if the TCFD’s proposals could help strengthen and enforce this guidance. He also proposed that they should create decision-useful high quality information, which not only accounts for industry risks, but also risks associated with individual companies. Lastly, he suggested that the TCFD take into consideration the human capital risks as well.

Elizabeth Lewis, Head of Sustainable Investing at the World Resources Institute, agrees that investors are assuming a more proactive position regarding sustainability, shifting their focus from current emissions to long-term scenarios and business risks. Lacking simple and straightforward guidance, however, they still struggle to make green investments and properly take climate risks into account. In this regard, unaligned frameworks across countries could bewilder investors, and the TCFD should - at least at the G-20 level – serve to unify and simplify guidance. This latter point was raised by Mr. Gleckman, who also believes in the importance of mainstreaming this new guidance once it is ready.

Adam Kanzer, Managing Director and Director of Corporate Engagement and Public Policy for Domini Social Investments, was critical of the vague objectives put forth by the Task Force—were they focusing on financial stability or climate change? Mr. Kanzer argued that in order for the objectives to be effective, the focus should be on the impacts of the company to the environment. Once the investors understand how climate change impacts their activities, they will be ready to address climate more directly. In essence, the scope of the FSB’s work needs to address risks: how to price it, how managers should address it, and what they should disclose.

It does not mean, however, neglecting the risks created by investors through their actions. Investors are not passive actors, who only receive risks, and should not be treated as so. But to internalize climate risks into their decision-making process, investors should have access to a comprehensive pricing model where the climate risks they generate are translated into impacts on their profits. In fact, the financial sector can only “manage what it measures”.

Nicolai Lundy manages the Education Team at the Sustainability Accounting Standards Board (SASB). He argues that climate-related disclosure reports are often useless, missing their objective to impact decision-making in the financial sector. The mistake arises from the misconception that disclosure and transparency is the end-goal of the process – whereas it should be treated as a tool to assess multiple indicators and aid financial actors in their managerial role.

In addition, Nicolai argues that disclosure reports are often presented in sector-unspecific formats, missing a lot of information that financial decision-makers need to acknowledge. The TCFD should focus on financial-specific disclosure guidance, addressing the different kinds of climate-related risks faced by investors, as well as their industry-specific formats. For example, how should pension funds and the credit rating industry incorporate climate-related considerations to decision-making? The TCFD should provide insightful in this regard.

Harris: How is the information provided in disclosure reports going to be used? Do we need to come up with metrics that are helpful to decision making?
**Simon Zadek**, Co-Director of UNEP Inquiry into the Design of a Sustainable Financial System, agrees that disclosure without considerations about how the financial system works is useless.

Mr. Zadek explained that this discussion, and the work of the Task Force, relies on four assumptions: Disclosure will change behavior; Climate is something important and has value; Transparency is somehow meaningful; and Materiality-based approach is the best way to forward.

He suggested that there is a need for more sophistication in assessing what disclosure means in practical terms. Perhaps there should be new model for stress-testing balance sheets. What we learn from stress-testing depends on how we build the scenarios. Which discount rates should be considered? Disclosure without considerations about how the financial system works is useless.

**OPEN DISCUSSION**

- Need to look closer at what risks the financial system imposes on the environment. The TCRD must grapple with risks from both sides, and connect its work with the objectives from COP21.

- It is important to ask the TF how they will consider “stranded assets”. Typically, investors want to avoid stranded assets, but in this case, the objective is to push certain assets to become stranded.

- The Task Force should also consider the equity implications of this work. Some countries are more exposed to the climate change - particularly small developing countries - and this may affects their sovereign credit rating. In fact, some countries like Vietnam have already been downgraded and face higher external financing costs as a result. As disclosure standards and the metrics for understanding climate-related risks evolve, the implications for developing countries will become even greater. The FSB Task Force should note this issues, as it relates to risks for sovereign debt markets and domestic economies.

- In terms of sovereign credit risks, these risks are actually borne upon society (a country’s population) who are not compensated for (not internalized) those risks.

- The TCFD should consider human capital risks as well, and the transition for workers in sectors such as oil and gas. Workers are often misinformed about their own jobs and the risks they are taking (task force should address those “inside risks”)

- Two different questions: How to make this task force better? What else should be done?

- It is important to find better ways to price climate-related risks, but the financial system is not going to moderate inequalities when the focus is on pricing risks.

- We should not forget that we are talking about many state-owned assets, and public sector liabilities are a huge part of the carbon picture.

- The financial sector operates on quarterly and annual basis, which puts the financial sector at a severe disadvantage in terms of adequately capturing and integrating risks related to climate change. The TCFD should look at the insurance sector models for risk, which are much better at
addressing issues with long-term time horizons.

- Inconsistencies among time frames - investors are thinking more about short-term risks to their investments than about long-term environmental risks

- The task force is industry led – which has good aspects, but also has disadvantages (missing NGOs, for example). The TCFD should have a greater diversity in its membership and forthcoming working groups. A diversity of ideas will be critical to defining “materiality” in way that captures the broad spectrum of climate-related risks. Need to think differently about materiality (financial system-specific)

- The environmental and financial communities use different terminology and where terminology is the same, the definition is different (such as: risks, equity or medium-term).

- It is important to note that overwhelming the TCFD with so many opinions may become a barrier to its work.

- FSB should make clear how we could replicate the initiative, since it will not itself solve all existing problems.

- It is important for investors to understand how climate change affects their activities, and it is important to focus on that. Once they go through this process they will address climate more directly.

- FSB is trying to “fix” the confusion arising from multiple kinds of recommendations and standards, but focus is on financial sector. Some are asking if the FSB Task Force is seeking to harmonize all these various frameworks - but why harmonize existing frameworks. The TCFD is focused on something different: financial stability. Therefore, it is important to translate many of these issues into the context of financial stability.

- Some of the panelists anticipate that the FSB Task Force recommendations will primarily “principle” based, as opposed to standards.

- Will the FSB align its recommendations with other disclosure standards?

- Are there mandatory measures suggested in the report? If not, what should be the strategy for implementation and adoption of the TCFD recommendations?
The TCFD Consultation for Phase 1:

Deadline: May 1, 2016

Consultation Report: https://www.fsb-tcfd.org/phase1reportdocument/

Consultation Questions (pg 58-59 of report) organized by theme:

**Topic #1** For the investor community, what are the major client-relevant disclosure issues that the Task Force should address? This is in response to FSB Task Force’s consultation questions #3,#5,#6,#8, and #14.

**Topic #2** For the environmental community, what are the major climate-relevant disclosure items that the Task Force should recommend? This is in response to their questions #5,#6,#8, and #17

**Topic #3** The Taskforce is expected to recommend climate-related disclosure requirements for financial institutions. What climate-related information would be most critical for financial institutions to disclose? This is in response to their questions #11, #12, #13, and #14

**Topic #4** What other topics should the Task Force consider in phase 2? This is in response to their questions #18, #20, and #21